9. SUMMARY AND IMPLICATIONS FOR ADEQUACY OF COMPENSATION

As part of the California Commission on Health and Safety and Workers' Compensation's comprehensive review of workers' compensation permanent partial disability, this report has investigated the long-term economic consequences of a disabling injury, the success of return to work, and the adequacy of compensation at private, self-insured employers in California. The analysis responds to stakeholder comment on an earlier report (Peterson et al, 1998) that showed significant and sustained losses as well as low replacement rates over the five years after injury at insured firms in California in 1991. Data on self-insured firms was previously unavailable, but anecdotal evidence and theoretical considerations suggested that self-insured employers would have better return to work, which would lead to improved outcomes for PPD claimants. The data for this report are from a unique combination of private claims data collected from 68 employers and linked to state administrative wage data.

We find that PPD claimants at private, self-insured employers in 1991-1995 experience significant earnings losses over the five years after injury. However, we also find that there is better (more sustained) return to work at self-insured employers. PPD claimants are more likely to continue to work during the quarters after injury, less likely to drop out or retire, and if employed, more likely to work at the at-injury employer. Improved return to work implies lower proportional earnings losses at self-insured than at insured firms. In particular, we find that while PPD claimants in 1993 at insured firms lost 32 percent of their earnings over the five years after injury, PPD claimants at self-insured firms lose 23 percent.

Despite more sustained return to work and lower proportional losses, we find that workers' compensation replaces an equal or lower fraction of losses at the self-insured than at the insured. This is a surprising result because lower proportional wage loss should suggest higher replacement rates. The difference is that claimants at self-insured firms have 50 percent higher earnings on average, and therefore higher absolute losses ($39,500 over the five years after injury at the self-insured, compared to $33,000 at the insured). At the same time, total benefits are largely invariant to earnings (due to benefit caps). The result is that claimants at self-insured employers have 48 percent of their pre-tax losses replaced, compared to 53 percent at the insured. A commonly applied standard for adequacy is two-thirds of pre-tax earnings replaced. These findings suggest that workers' compensation benefits for permanent partial disability claimants in California are not adequate.

We identified the same pattern of replacement rates across pre-injury earnings groups within the self-insured and the insured: Workers with higher earnings had replacement rates considerably lower than workers with lower earnings. For instance, the bottom quartile of earnings at the insured had a replacement rate of 90 percent, compared to the replacement rate for the top quartile of 37 percent. At the self-insured, the bottom and top earnings quartile had replacement rates of 58 percent and 36 percent, respectively. These differences across earnings groups within the insured and self-insured, and similar differences across firm size groups, suggest that the differences between the self-insured and the insured can largely be explained by differences in firm size and pre-injury earnings of claimants.

As in Peterson et al (1997), we found lower replacement rates among the lowest indemnity (low-rated) claims at both insured and self-insured firms. The lowest 20 percent of indemnity had 14 percent of earnings loss replaced at the self-insured, and 11 percent at the insured. This result did not extend to all lower-rated claims at the self-insured. The second 20 percent of indemnity had 61 percent of earnings loss replaced (32 percent at the insured). In general, we found better outcomes for low-rated claims at the self-insured than at the insured. We particularly found better outcomes for higher-earnings, low-indemnity PPD claims at the self-insured, who had very high rates of return to work and very low proportional earnings losses (5-7 percent). This group, which is perhaps the easiest to accommodate and the most attached to the labor force, best exemplifies the success of return to work at the self-insured.

The results on adequacy of compensation of this study do not lend themselves to simple solutions. For instance, one solution could be to raise benefits for low-rated claims. While low replacement rates are observed among low-indemnity (low-rated) claims, this association does not necessarily imply that uncompensated losses are high in this group. In particular, by many alternative measures of adequacy, high-earnings, low-indemnity claims at the self-insured are well compensated. Another solution is to increase compensation for the high-rated claims. However, once again, by any reasonable measure, the lowest pre-injury earnings, high-indemnity claims at the insured are well compensated, with replacement rates in excess of 100 percent over the five years after injury. Raising caps to target high earnings claimants would, again, raise benefits for one of the workers' compensation successes, workers with low-indemnity and high-earnings at the self-insured.

The lack of a simple solution should not stand in the way of addressing clear issues of adequacy (such as high uncompensated losses among high-indemnity, high-wage earners), and equity (such as low replacement rates among the lowest-rated claims, particularly at the insured). But while fine-tuning the compensation may be appropriate in the short run, the lack of obvious policy levers to do so suggests that more fundamental solutions need to be considered. In particular, further effort is required to improve return to work, particularly among smaller firms. In addition, disability ratings, which determine most of the differences in compensation, need to be revised to more accurately target individuals with greater losses. Alternative approaches to setting benefits should be considered, such as increasing benefits for workers who do not receive an offer of return to work. Finally, if the resulting approach to setting compensation is more consistent, it could reduce litigation and help restore confidence in the system.